PROTECTIVE COMMITTEES

CHESTER ROHRLICH †

The current depression in security prices has not as yet changed the trend towards wide-spread ownership of corporate securities [1] and it is too early to determine the long-range effects of the concentration of security-holdings resulting from the increased use of trust devices.[2] It however remains safe to assume that within the discernible future the average individual security holding in the large American corporations will be, as it now is, infinitesimally small. The result is utter powerlessness on the part of a lone security-holder to participate effectively in corporate matters. Ordinarily he recognizes and accepts this state of affairs. He makes no pretense of exercising any power of ownership theoretically his. Even "proxy-voting", the usual limit of his participation, is valued so lightly that it is reported that a small minority stockholder once obtained control of a large corporation by the simple expedient of mailing *stamped* return envelopes with the proxies he solicited whereas those who were in control at the time sent out unstamped return envelopes.[3] In a recent popular book [4] the author, a professor of law, remarks:

> "Stockholders, especially small ones, are surprisingly indifferent to all corporate ills and abuses, especially while dividends are being paid. The lack of participation by stockholders in the actual management and control of their corporations is itself perhaps the worst corporate evil. The enormous number of shareholders may be in part responsible for this. . . . When corporations have stockholders numbering in the many thousands, it becomes impossible to hold corporate meetings which amount to anything. . . . The growing tendency to corporate control by a small group, which in turn often is controlled by one man, has given rise to a reign of corporate oligarchy. The many have been drowned out by the few. The shareholders have become an empty cipher. . . . If stockholders refuse or neglect to protect themselves; if conditions are such as to make it difficult or impossible for them to do so, the State must take up the cudgels in their behalf."

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† LL. B., New York University, 1921; member of New York Bar; contributor to numerous legal periodicals.

[1] Between December 31, 1929 and December 31, 1931 the number of holders of common shares in sixty-nine leading corporations increased 48.8 per cent. At the end of 1931 over 4,000,000 persons owned the common stock of the sixty-five leading corporations listed on the New York Stock Exchange. Some average individual holdings were: United States Steel, 49.9 shares; American Tele. & Tele. Co., 29 shares; General Motors Corporation, 14.7 shares. See New York Times, Feb. 7, 1932, Part 2, page 9.

[2] Meaning investment trusts, life insurance companies, living and testamentary trusts under corporate trustees, and similar arrangements whereby single organizations are given power (whether or not accompanied with beneficial ownership) over large investment funds.

[3] THE AUTOBIOGRAPHY OF LINCOLN STEFFENS (1931) 533.

[4] WORMSER, FRANKENSTEIN, INCORPORATED (1931), 156 *et seq.*

However, there are times when these stockholders, and holders of other classes of corporate securities, are eager to influence the course of corporate affairs. The possible issues are multifarious and not confined to the financial reorganization of insolvent companies.[5]

Illustrative of such issues are questions of policy with respect to the merger or sale of the company or with respect to dividends.

A recent *cause celebre* was the ill-fated Youngstown-Bethlehem merger. Immediately upon announcement of the proposed merger by the directors of Youngstown, its stockholders split into hostile camps. Proxy committees, *pro* and *con,* were organized [6] and these carried on intensive campaigns for proxies wherein every conceivable method was employed.[7] The struggle was carried to the courts where the battle was equally intense; [8] the decision was unfavorable to the proponents of the merger and the result was its abandonment.[9]

A somewhat unique problem faced the security holders of the privately owned transit lines in New York City as a result of attempts made for their "unification".[10] One of the companies, The Interborough Rapid Transit Company, was in control of voting-trustees acting under a voting-trust agreement of 1922 and certain holders of voting-trust certificates, having different views than the trustees concerning the proper method of dealing with the situation, organized a Protective Committee [11] under a deposit agreement [12] which provided for the deposit with the committee of both voting-trust certificates and shares of capital stock which had not been deposited under the voting-trust. The object of the organization of this Protective Committee was to give these security holders direct representation in negotiations with the City.

An interesting controversy over dividend and capital policies faced the Northern Pipe Line a few years ago. A group of stockholders felt that the company had cash in excess of its business requirements and that this excess should be distributed to stockholders. Unable to persuade the management of the soundness of their opinion, they organized a proxy-committee

[5] Legal limitations upon reorganizations will not be considered in this paper. See Cravath, *The Reorganization of Corporations,* SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION (1917) 153; Swaine, *Reorganization of Corporations: Certain Developments in the Last Decade,* SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION (1931) 133. For committee problems resulting solely therefrom, see Note (1928) 41 HARV. L. REV. 377; Rodgers, *Rights and Duties of the Committee in Bondholders' Reorganizations* (1929) 42 HARV. L. REV. 899.

[6] New York Times, March 14, 1930, at 28.

[7] New York Times, March 19, 1930, at 38; March 20, 1930, at 44; March 21, 1930, at 38; March 23, 1930, pt. ii, at 16, pt. iii, at 2.

[8] New York Times, Jan. 8, 1931, at 36; Jan. 25, 1931, at 26.

[9] New York Times, Oct. 16, 1931, at 34.

[10] A similar situation exists in Chicago. There too Protective Committees were organized (1930).

[11] New York Times, March 15, 1930, at 1.

[12] Dated, March 15, 1930.

which carried the issue directly to the stockholders.[13] The proxies obtained enabled this committee to elect two out of five directors at the next annual meeting of the company.[14] This was followed by a cash distribution of $2,000,000.[15]

It is obvious that upon such occasions the individual security holder must find his lone efforts doomed at the outset to futility. Equally obvious is it that union with other security holders of like mind affords a remedy for the individual's weakness.

The random illustrations of internal corporate controversies adverted to have indicated three devices in use for the effectuation of such unions, the proxy-committee, the voting-trust, and the protective committee. They have much in common, but also very substantial differences.

Proxy-Committees

A proxy has been simply defined as "an authority by one, having the right to do a certain thing, to another to do it".[16]

Although proxy-voting in corporations was not a common-law right, it is now well-nigh universally validated by statute.[17] The governing law is well settled: it is merely one aspect of agency law.[18]

It has become the practice for corporations to solicit proxies from stockholders "unable to attend" running in favor of proxy-committees (meaning by the term the persons, usually more than one, named in the conjunctive and alternative, designated as the proxies) frankly selected by the existing board of directors. In cases of conflict on corporate policies, as we have already seen, opposition proxy-committees may be created which solicit proxies from the stockholders.

The limitations of this method are inherent in the law of the subject. By reason of the revocability of proxies, the proxy-committee has no assurance that before it acts its proxies will not be revoked, either by express revocation, the execution of a later proxy to another, or by the personal attendance of the stockholder at the meeting. Because of this factor, the proxy-committee as a means of corporate control may be used effectively only in short contests. Furthermore, the method affords no means for raising funds whereby prolonged investigation or litigation may be conducted.[19]

To achieve "irrevocable proxies", the voting-trust was developed.

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[13] New York Times, Dec. 29, 1927, at 38.
[14] New York Times, Jan. 20, 1928, at 28.
[15] New York Times, March 29, 1928, at 39; June 14, 1928, at 38; June 16, 1928, at 28.
[16] Manson v. Curtis, 223 N. Y. 313, 319, 119 N. E. 559, 561 (1918).
[17] THOMPSON, CORPORATIONS (3d ed. 1927), § 968.
[18] The corporation statutes frequently makes special rules; *i. e.*, that proxies must be in writing and are not valid after a certain period of time—see N. Y. GENERAL CORP. LAW § 19. It is also sometimes provided that proxies may not be sold—see N. Y. STOCK CORP. LAW § 47, and N. Y. PENAL LAW § 668.
[19] In practice, an opposition proxy-committee may itself initially represent such substantial financial interests in the corporation as to make the raising of funds from outsiders unimportant. In such cases proxies are solicited for the necessary votes or for the "moral" effect.

Voting-Trusts

The fundamental differences between a proxy and a voting-trust have been summarized thus,[20]

> "The usual proxy merely establishes a relation of principal and agent terminable by the principal at will either through revocation or through sale of his stock. The voting trust agreement vests in the trustee an interest in the stock which the original owner obviously is unable to nullify by any sale of the stock and which he cannot otherwise cancel except through an attempted breach of contract. The holder of a proxy has no control over the stock itself, while the voting trustees have the possession of the stock as well as the legal title to it. The proxy creates a relation of a temporary character under a restrictive statutory authority; the voting trust is created without the need of statutory license [21] and confers not a revocable authority upon an agent but a qualified title upon a transferee of property."

The law of voting-trusts has been many years in the making. Early decisions date from a period when the nature of business corporations (at least as now known) was little understood and even less sympathized with.[22] Voting trusts also labored under the odium which at one time attached to the use of "trusts" as means of achieving business monopolies. The result has been a vast accumulation of learning and precedent, with its inevitable burdens as well as benefits.[23]

In this paper the law of protective committees is treated *as if* it were in all cases independent of the law of voting-trusts, leaving it to the courts to draw analogies when desirable and, it is hoped, to overlook them when inconsistent with present-day needs and practices.

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[20] CUSHING, VOTING TRUSTS, (2d ed. 1927) 162-3.

[21] This statement is not universally true: the common law of voting-trusts is uncertain (*infra*). As to the effect of the enactment of voting-trust statutes upon the common law, see Matter of Morse, 247 N. Y. 290, 160 N. E. 374 (1928); Mackin v. Nicollet Hotel, 25 F. (2d) 783 (C. C. A. 8th, 1928). The OHIO GENERAL CORP. ACT (1927) permitting voting trusts, expressly provided that the rights conferred were "in addition to rights at common law" § 34.

[22] Prof. Wormser, *op. cit. supra* note 4, at 48, fixes 1875 as the year when "the modern American law of corporations was well under way". Even at that early date the voting trust was already in use (see Cushing, *op. cit. supra* note 20, at 4 *et seq.*) and a decision with respect to a very similar instrument was rendered as early as 1867, Brown v. Pacific Mail S. S. Co., Fed. Cas. No. 2,025, at p. 420 (C. C. S. D. N. Y. 1867).

[23] For those desirous of plowing this field beyond the scope of this paper, reference is made to: Lilienthal, *Corporate Voting and Public Policy* (1887) 10 HARV. L. REV. 428; Baldwin, *Voting Trusts* (1892) 1 YALE L. J. 1; Moore, *Voting Trusts in Corporations* (1902) 36 AM. L. REV. 222; Rogers, *Pooling Agreements Among Stockholders* (1910) 19 YALE L. J. 345; Wormser, *Legality of Corporate Voting Trusts and Pooling Agreements* (1918) 18 COL. L. REV. 123; Smith, *Limitations on the Validity of Voting Trusts* (1922) 22 COL. L. REV. 627; Finkelstein, *Voting Trust Agreements* (1926) 24 MICH. L. REV. 344; CUSHING, VOTING TRUSTS (2d ed. 1927), having in mind Matter of Morse, *supra* note 21; Bergerman, *Voting Trusts and Non-Voting Stock* (1928) 37 YALE L. J. 445. For Pennsylvania cases, see Boyer v. Nesbitt, 227 Pa. 398, 76 Atl. 103 (1910) and Commonwealth v. Roydhouse, 233 Pa. 234, 82 Atl. 74 (1911).

Protective Committees

Standing halfway, in more than one sense, between the proxy and the voting-trust is the protective committee. Despite the close relationship of all three, the protective committee differs fundamentally from both the proxy-committee and the voting-trust. Before entering upon the detailed study of the protective committee, it is well to note these basic differences.

Of the three, the protective committee alone is suited for use by the holders of non-voting securities, such as bonds or non-voting classes of stock.[24] Both proxy committees and voting-trustees must, in general, achieve their ends by the election of a favorable board of directors and then through that board. This feature is dominant in the very definition of a voting trust. "A voting trust agreement accumulates in the hands of a person or persons shares of several owners, in trust for the purpose of voting them, in order, through the selection and election of directors, to control the corporate business and affairs." [25] On the other hand, a protective committee may achieve its purpose not only through the board of directors but where necessary against the wishes of the board, having in appropriate cases the aid of the judicial machinery. This essential difference is functionally recognized. The usual voting trust agreement confines the power of the trustees to the election of directors and the collection of dividends and their distribution to the certificate holders. As we shall see, protective committees are generally empowered to do all things expedient in procuring the desired result.[26]

A characteristic difference in point of view between the voting trust and the protective committee (and also the opposition proxy-committee) is likewise important. The former is directed towards general stability in management, the maintenance of the *status quo* [27] for a number of years; the latter towards the overturn of the *status quo* (in part at least) for the accomplishment of a special, specific purpose. This difference is not frequently found as explicitly delineated as it was in the case of the Seaboard Air Line Railway. Early in 1904 the company was under the control of a group of bankers by virtue of a voting trust theretofore created in connection with certain financing, but differences of opinion on financial matters soon arose and an opposition stockholders' protective committee was organized by another group of bankers.[28] The deposit agreement expressly au-

[24] In the Interborough Rapid Transit Company unification matter above referred to, one Deposit Agreement (dated March 15, 1930) provided for the deposit with the same committee of capital stock and voting trust certificates therefor.

[25] Manson v. Curtis, *supra* note 16, at 319, 119 N. E. at 561 (1918).

[26] It should perhaps be expressly noted that in treating protective committees as a device for corporate-control, the word "control" is not used solely in its limited sense of command over a majority of the voting stock, but also in the broader sense of power to use the corporation for the realization of a desired end.

[27] In reorganizations, the voting trust device is used to assure continuance of the status brought about by the reorganization.

[28] (1904) 79 COMMERCIAL & FINANCIAL CHRONICLE 152, 734.

thorized the committee to institute an action for the dissolution of the voting trust.[29]

As an outgrowth of these fundamental differences it is generally true that voting trusts aim to continue in being as long as legally possible, with substantially no power of withdrawal in the depositor, whereas protective committees endeavor to terminate their existence as soon as their objects can be achieved, or accomplishment becomes patently impossible, and allow considerably freer exercise of the right of withdrawal.[30]

The protective committee has a place peculiarly its own in corporate affairs, a place which it has already achieved and promises to continue to hold; it is well to endeavor to understand it.

The Committee

The committee is self-constituted, willing itself into being. The present tendency is to invite, in addition to large holders of the security, men of experience and prestige so that their names will serve to create confidence in the committee.[31] Committee members need not have any personal interest in the security or the corporation.[32] An officer of the corporate-trustee under a bond-indenture may serve on a committee for holders of bonds issued thereunder [33] but that circumstance may induce the court in a foreclosure suit brought by the trustee to permit non-depositing bondholders to intervene.[34] While the practice is looked upon with varying degrees of favor, or disfavor, by different courts, even a receiver of the corporation may act as a member of a committee of its security holders and will be required to resign only when a conflict between his two trusts is foreshadowed.[35] It would seem that an officer of the corporation, owing a trust duty to all its security holders, should not place himself in a position of acting only for some of them.[36]

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[29] Cushing, *op. cit. supra* note 20, at 25. A similar situation existed in the Interborough unification matter above mentioned; but there the "protective committee" directed its efforts towards electing a voting trustee favorable to its views, rather than towards attacking the voting trust agreement *per se* (see New York Times, Aug. 26, 1930, at 3). The voting trust agreement, dated Oct. 1, 1922, provided that vacancies among the trustees be filled by vote of the certificate holders and that the trustees should elect as directors of the Company persons nominated by various financially interested groups, including the certificate holders.

[30] A few more particular differences between voting trusts and protective committees are reserved for note hereafter.

[31] GERSTENBERG, FINANCIAL ORGANIZATION & MANAGEMENT (1924) 663; DEWING, FINANCIAL POLICY OF CORPORATIONS (1926) 937-8. In a recent matter (Associated Rayon Corporation) two banking houses acting in their firm names constituted the Committee (see New York Times, May 14, 1930, at 45, 46). The protective agreement, dated May 14, 1930, provided: "S. & Co. and L. Brothers shall act respectively as copartnerships and in case of any change in either firm such firm as from time to time constituted shall be deemed parties of the second part hereunder, as though originally named herein, and the survivors or continuing members of any such firm may execute any assignment or transfer necessary to vest in the successor firm all powers, rights, or title of the prior firm hereunder."

[32] Haines v. Kinderhook & Hudson Ry., 33 App. Div. 154, 53 N. Y. Supp. 368 (1898).

[33] Palmer v. Bankers Trust Co., 12 F. (2d) 747 (C. C. A. 8th, 1926).

[34] Central Trust Co. v. Chicago, R. I. & P. R. R., 218 Fed. 336 (C. C. A. 2d, 1914).

[35] Fowler v. Jarvis-Conklin Mtge. Co., 63 Fed. 888 (C. C. S. D. N. Y. 1894).

[36] Jackson v. Ludeling, 88 U. S. 616 (1874).

The committee informally brought together takes its legal status, *nunc pro tunc* as it were, from the "deposit agreement" which it prepares to give itself formal being.

The Deposit Agreement and the Powers, Duties and Liabilities of the Committee Thereunder

The committee's counsel should not, in the words of Paul D. Cravath,[37] "attempt to evolve a deposit agreement out of his own consciousness". So many agreements are now readily available that they should be freely used as models;[38] however, the availability of forms and the ease of the "scissors and paste" method must not lead to forgetfulness of the need to frame each agreement to meet its specific purpose. This must be sought after, not by narrow limitations, nor by undue reliance upon mere broad sweeping general clauses.

The parties to the agreement are the members of the committee, who execute the instrument, and the depositors, who become such under the provisions of the agreement, either by executing the agreement, or merely by depositing their securities and accepting certificates of deposit therefor.[39]

After the usual designation of the parties and the recital of the circumstances leading to the execution of the deposit agreement, the customary form proceeds more or less along the following outline:

(A) The Committee is constituted as such.
(B) Provision is made for the deposit of the designated securities.
(C) The Depositary is named and its powers and duties are set forth, as are the powers of the Committee with respect to the depositary.
(D) The depositors agree not to take any independent action with respect to the deposited securities, and the rights of the Committee in and to the deposited securities are defined.[40]

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[37] CRAVATH, *op. cit. supra* note 5, at 164.

[38] A "bondholders' protective agreement" in a reorganization is analyzed and printed in full in TRACY, CORPORATE FORECLOSURES (1929) 15-19, 409-427. Dewing, in his FINANCIAL POLICY OF CORPORATIONS (1926), quotes at length the late Adrian H. Joline's summary FLETCHER, CORPORATION FORMS (2d ed., 1923) 746, 1503. Mr. Cravath's lecture, *supra* note 5, contains many helpful suggestions as to their preparation. Many of the cases cited in this paper contain lengthy quotations from, and detailed descriptions of, the agreements involved. Four voting trust agreements are printed in full in CUSHING, *op. cit. supra* note 20, but it should be noted that one of them (Bank of America) was held invalid in Matter of Morse, *supra* note 21.

[39] The depositary may, but need not, be a party. If the committee is empowered to employ a depositary, it may do so, and the depositary need not be a party to the agreement in order to act. It is well, however, to procure the depositary's approval of the proposed deposit agreement, because it is vitally concerned with the provisions thereof, particularly with those dealing with its duties and immunities. It is customary to name the depositary in the agreement and give the committee power to change it.

[40] In the older forms the committee was generally described as having title to the deposited securities and all the rights of owners. In the newer forms the committee is given the same broad powers, but to be exercised by virtue of an irrevocable power of attorney from the depositors to the committee, the depositors reserving title until such time as the committee, at its option, elects to take title, which option is generally exercisable by the filing of a notice of election with the depositary. One advantage of this procedure is to en-

(E) Terms and conditions of deposit, such as time within which deposit must be made, the committee being given power to vary.[41]

(F) Provisions with respect to the issuance, transfer, registration, etc., of certificates of deposit.

(G) Methods of giving notice to depositors.

(H) Specific powers to meet the particular situation.[42]

(I) Provisions with respect to dissent and withdrawal by depositors.[43]

(J) General powers to committee.[44] Among the customary ones are: *a* To add to their number, accept resignations and fill vacancies; *b* To act by a majority [45] and the members by proxy; *c* To employ depositary, counsel, engineers and other agents, and to pay them; *d* To fix their own compensation; [46] *e* To use the deposited securities for expenses and for purposes of plan either by sale or pledge or otherwise; [47] *f* To adjust claims and institute suits; *g* To construe the agreement,[48] supply omissions, correct defects and (usually only with the consent of a specified percentage of the depositors) to change the agreement; [49] *h* To deal for their own individual benefit with securities of the class called for deposit, and to deal with the corporation.[50]

(K) Exculpatory clauses in favor of committeemen designed to limit liability of each for his own wilful misconduct only,[51] and in favor of depositary, particularly aiming to protect it in acting upon directions of the committee.

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able the committee to file a larger number of claims in bankruptcy. Voting trustees are generally given the full powers of "absolute owners", subject only, in some cases, to special limitations.

[41] When it is doubtful whether the value of the deposited securities will be sufficient to create a fund for committee expenses, the payment of a sum may be made a condition of deposit. Although voting trustees generally reserve the power to charge certificate holders with expenses and to withhold such charges from dividends received, the more usual practice is to place the burden of the expenses upon the corporation; but see Clark v. National Steel & Wire Co., 82 Conn. 178, 72 Atl. 930 (1909), where it was held that, the corporation not being a party to the voting trust agreement, it could not pay expenses incurred by the trustees thereunder.

[42] Express powers will not be extended by "construction", Industrial General Trust, Ltd. v. Tod, 170 N. Y. 233, 63 N. E. 285 (1902). It is proper to provide that any contemplated new corporation may be organized under the laws of a state to be selected by the committee, even if the laws of such state differ from those of the domicile of the old corporation or from that of the situs of the agreement, Cowell v. City Water Supply Co., 130 Iowa 671, 105 N. W. 1016 (1906).

[43] It is usual to require as a condition for the exercise of the right of withdrawal the payment of a *pro rata* share of the expenses.

[44] No general powers are implied, Industrial General Trust, Ltd. v. Tod, *supra* note 42.

[45] Haines v. Kinderhook & Hudson Ry. Co., *supra* note 32; Coppell v. Hollins, 91 Hun 570, 36 N. Y. Supp. 500 (1895), *aff'd*, 159 N. Y. 551, 54 N. E. 1089 (1899).

[46] But the compensation which the committee vote to themselves is subject to judicial review, Livingston v. Falk, 217 App. Div. 360, 217 N. Y. Supp. 131 (1926).

[47] The committee would have implied power to make necessary expenditures, Cowell v. City Water Supply Co., *supra* note 42.

[48] The committee's construction must be fair, not arbitrary, and made in good faith, Industrial & General Trust, Ltd. v. Tod, *supra* note 42; Industrial & General Trust, Ltd. v. Tod, 180 N. Y. 215, 73 N. E. 7 (1904).

[49] A provision to the effect that all depositors shall be bound by the action of a majority is valid, Olcott v. Powers, 60 Hun 583, 15 N. Y. Supp. 263 (1891).

[50] Such a clause waiving the usual contrary rule applicable to trustees is valid, Miller v. Dodge, 28 Misc. 640, 59 N. Y. Supp. 1070 (1899).

[51] No one member would be liable for the defaults of another, Riker v. Alsop, 27 Fed. 251 (C. C. S. D. N. Y. 1886), *rev'd*, (on other grounds), 155 U. S. 448, 15 Sup. Ct. 162 (1894). As to exculpatory clauses generally, *infra*.

(L) Relieving the committee from responsibility for failure of plan; in some agreements the committee expressly undertakes to endeavor in good faith to carry out purpose.[52]

(M) Denying power to committee to obligate depositors personally, but subjecting the deposited securities to all charges incurred by committee.

(N) Provisions as to expiration and termination.

(O) Procedure for accounting by committee.

(P) Disclaimer of any obligations to non-depositors.

The deposit agreement is of course a contract and its terms may not be disregarded.[53] In so far as its construction is concerned, the courts endeavor to apply two principles, leaning towards one or the other as the equities of the situation as seen by the particular court seem to demand. The first of these rules of construction is that the deposit agreement will be construed most favorably to the depositors and strictly against the committee.[54] The second of these principles is that the agreement will be construed liberally to enable the committee to achieve the desired results.[55]

A good indication of how the courts have actually met this inconsistency —verbal inconsistency at least—can be obtained from looking at a few cases wherein questions as to the powers of reorganization committees were involved.

In *Mills v. Potter*,[56] the court expressly accepted as sound the rule that the agreement "should be construed strictly", but proceeded, in view of the "peculiar" circumstances and the "situation of the parties", in this case to give the agreement a rather broad and liberal meaning. The agreement involved was a usual reorganization agreement under which the committee was specifically authorized to purchase the property upon foreclosure, raise money for "the purposes of the agreement" and "supply defects or omissions in the plan". The committee was required to allot "to the certificate

[52] It would seem that such an obligation should be implied, but see Colonial Trust Co. v. Wallace, 183 Fed. 897 (C. C. S. D. N. Y. 1910).

[53] Cox v. Stokes, 156 N. Y. 491, 51 N. E. 316 (1898); Habirshaw Electric Cable Co. v. Habirshaw Electric Co., 296 Fed. 875 (C. C. A. 2d, 1924). Deposit agreements have not been subjected to the attacks on their validity which were so vigorously urged against voting trust agreements. This may be due to the fact that most deposit agreements which have reached the courts involved bonds, rather than voting stocks, where the legal problems are somewhat more difficult. It may also be due to the trend away from such attacks even where voting trust agreements are involved. This trend can be readily noted by reading the material cited under note 23 chronologically, and by comparing the first edition of THOMPSON, CORPORATIONS (1895) §§ 6404-6414, with the third edition of the same work (1927) § 991. The trend was noted by the courts in Carnegie Trust Co. v. Security Life Ins. Co., 111 Va. 1, 68 S. E. 412 (1910) and in Mackin v. Nicollet Hotel, *supra* note 21.

[54] Carter v. First Nat. Bank, 128 Md. 581, 98 Atl. 77 (1916); Industrial & General Trust, Ltd. v. Tod, 170 N. Y. 233, 180 N. Y. 215, *supra* note 48; United Water Works v. Omaha Water Co., 164 N. Y. 41, 58 N. E. 58 (1900). This rule is justified on the double ground that the depositors are *cestuis que trusts* and that the agreement is prepared by the committee.

[55] Venner v. Fitzgerald, 91 Fed. 335 (C. C. S. D. N. Y. 1899); White v. Wood, 129 N. Y. 527, 29 N. E. 835 (1892).

[56] 189 Mass. 238, 75 N. E. 627 (1905).

holders their proportionate interests in the securities of any new company which may be organized". The plan and circulars issued by the committee indicated that improvements to the property were necessary and that new money would be required for that purpose. The court held that the committee acted properly in continuing to hold the stock of the new corporation to which the property had been conveyed "for a reasonable time" and during that time to cause the corporation to make contracts and raise moneys for improvements by means of a mortgage prior in lien to the securities distributable to the depositors.

A New Jersey court[57] showed the same spirit when it construed "matters of detail" to include not only formal matters "but also such alterations in the terms of the agreement itself (not changing the plan) as might be deemed necessary or advisable to effectuate the object". The reorganization agreement there provided for the issuance of bonds payable "in thirty years", and the court held it to have been within the province of a "committee of detail", appointed to carry out the plan, to grant the corporation the option to prepay the bonds before maturity.

In sharp contrast are the decisions rendered against the "Bondholders' Committee" in the American Water Works reorganization by the New York Court of Appeals[58] and by a federal court sitting in Massachusetts.[59] In these cases a clause of the agreement reading:

> "The committee shall prior to the conveyance of any purchased property to a new company, submit to the certificate holders a detailed plan of reorganization, which shall be binding upon all said holders, unless the holders of a majority in interest of the outstanding certificates shall, within thirty days, file with the trust company their written dissent from said plan . . ."

was construed to give to the committee power only to provide for "details", "minor particulars", and not "matters of substance". Accordingly a plan providing for recognition of junior security holders[60] was held outside the provisions of the agreement, and the creation of a voting trust of the stock of the new corporation was held violative of the requirement in the agreement that the "committee shall, after payment of the expenses of foreclosure and all expenses incurred by the committee, and its compensation, allot to the certificate holders their proportionate interests in the new company".[61]

[57] Lehigh Coal & Navigation Co. v. Central R. R., 34 N. J. Eq. 88 (1881).
[58] United Water Works Co. v. Omaha Water Co., *supra* note 54.
[59] United Water Works Co. v. Stone, 127 Fed. 587 (C. C. D. Mass. 1904).
[60] See also Farmers Loan & Trust Co. v. Centralia & C. R. R., 96 Fed. 636 (C. C. A. 7th, 1899) where it was held that a bondholders' committee was not authorized to consent
[61] Warren v. Pim, 65 N. J. Eq. 36, 55 Atl. 66 (1903); Warren v. Pim, 66 N. J. Eq. 353, 59 Atl. 773 (1904) (which contain an exhaustive discussion of the validity of voting trusts) involved questions as to the extent to which a committee may go in setting up a voting trust, even where its creation was specifically, but in general terms, authorized by the depositors.

Because of these variations depositors were held not bound by the plan notwithstanding the fact that a majority had not dissented.

Another reorganization committee, which had very broad powers to deal with property acquired upon a foreclosure sale and which was specifically authorized to create such liens "as may be necessary in the discretion of the committee to carry out the plan . . . or to protect or develop the said property . . . or for any purpose the committee may deem wise or necessary", determining that exploration work was necessary, entered into an agreement with an "Exploration Company" under which it was to do the work and expend such sums "as in its uncontrolled discretion it deemed necessary" and for the repayment of which it was given a lien. Despite the conceded good faith of the committee and the Exploration Company,[62] it was held that the agreement was beyond the powers of the committee on the ground that it could not delegate the discretion vested in it to another.[63]

One of the unsettled problems is the effect to be given the exculpatory clauses of the agreement, which ordinarily in the most sweeping terms seek to relieve members of the committee from any liability except personal liability for wilful default. The question is, of course, part of the general problem as to how far liability may be contracted away, and more specially by fiduciaries.[64]

It may be stated that no provision can shield the committee from liability if it acts in bad faith.[65] If the court finds bad faith, the committee may be held liable for the losses sustained without regard to whether the members of the committee profited personally and without the necessity of first setting aside the deposit agreement.[66] On the other hand, when the court finds that the committee acted in good faith, the exculpatory clauses will be given full effect.[67] In such cases there is no liability for errors of judgment or for being "overreached" when the agreement stipulates that there is no liability except for "wilful malfeasance or gross negligence".[68] The danger lies in the possibility that a court may conclude that a breach of the deposit agreement is proof of bad faith.

In *Industrial & General Trust, Ltd. v. Tod,*[69] the agreement conferred "almost unlimited powers" upon the committee, gave it power to construe the agreement and supply omissions, and the committee was expressly exempted from liability except for "wilful misconduct". The committee failed

[62] But it should be noted that the committee had failed to disclose the agreement with the Exploration Company to the depositors.

[63] Titus v. U. S. Smelting, R. & M. Exp. Co., 231 Fed. 205 (1916), *aff'd,* 240 Fed. 881 (C. C. A. 2d, 1917).

[64] See Posner, *Liability of the Trustee Under the Corporate Indenture* (1928) 42 HARV. L. REV. 198, 239; Benton v. Safe Deposit Bank, 255 N. Y. 260, 174 N. E. 648 (1931).

[65] Parker v. New England Oil Co., 13 F. (2d) 158 (D. Mass. 1926), *rev'd,* 19 F. (2d) 903 (C. C. A. 1st, 1927).

[66] *Ibid.*

[67] Van Siclen v. Bartol, 95 Fed. 793 (C. C. E. D. Pa. 1899).

[68] *Ibid.*

[69] 180 N. Y. 215, 73 N. E. 7 (1904).

to publish a plan of reorganization until *after* the reorganization had been completed. The provisions of the agreement were construed to have *impliedly* required the publication of a plan *before* reorganization, so that the depositors might have a reasonable opportunity to dissent, and the committee was held liable to a depositor.[70]

The Depositary and its Certificates of Deposit

As we have seen, it is more usual not to require would-be depositors to sign the deposit agreement, but to provide for their adhesion to the agreement by the deposit of securities and the acceptance of a certificate of deposit therefor. These certificates are usually issued by a trust company chosen by the committee as its "depositary". The trustee under a bond-indenture may act as depositary for a committee of holders of bonds issued thereunder.[71] Certificates of deposit are, at common law, not negotiable instruments,[72] but every effort is made to render them negotiable in fact and in law. In form they are made transferable either by mere delivery (bearer certificates) or by transfer on books kept for that purpose by the depositary. It is not infrequent to list certificates of deposit upon stock exchanges, if the securities they represent are so listed. Legal negotiability is sought after by appropriate provisions in the deposit agreement.[73] Negotiability may, of course, be conferred by statute.[74]

In general the situation with regard to the issuance and transfer of certificates of deposit is analogous to that with regard to corporate stock.[75]

The requirement of the agreement that the security must be deposited with the depositary in exchange for its certificate of deposit may be waived by the committee, and it is waived, if the committee, by one of its members or officers, accepts a security tendered for deposit.[76]

Depositors

The "depositors" are, by definition, those who are parties to the deposit agreement by virtue of holding certificates of deposit.[77]

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[70] The only indication of "bad faith" in the opinions is that the committee had assured the plaintiff that a plan would be formulated in advance. On the other hand, one of the dissenting justices pointed out that there was no charge of either fraud or wilful misconduct.

[71] Fidelity Trust Co. v. Washington-Oregon Corp., 217 Fed. 588 (W. D. Wash. 1914); Palmer v. Bankers Trust Co., 12 F. (2d) 747 (C. C. A. 8th, 1926); Guaranty Trust Co. v. Chicago, M. & St. P. Ry., 15 F. (2d) 434 (N. D. Ill. 1926).

[72] Chicago, R. I. & P. R. R. v. Howard, 74 U. S. 392 (1868).

[73] As to whether negotiability may be conferred by agreement, see Evertson v. National Bank of Newport, 66 N. Y. 14 (1876); Enoch v. Brandon, 249 N. Y. 263, 164 N. E. 45 (1928); Note (1924) 33 YALE L. J. 302.

[74] See Article 8 (adopted 1926) of N. Y. PERSONAL PROPERTY LAW dealing with "security receipts".

[75] Cassagne v. Marvin, 143 N. Y. 292, 38 N. E. 285 (1894). This is also true of voting trust certificates, see Union Trust Co. v. Oliver, 214 N. Y. 517, 108 N. E. 809 (1915).

[76] Hitchock v. Midland RR., 33 N. J. Eq. 86, (1880), *aff'd*, 34 N. J. Eq. 278.

[77] The failure actually to receive a certificate of deposit will not deprive one of the right to participate, if in fact he has deposited with the committee, Hitchock v. Midland RR., *supra* note 76.

Ordinarily—and it should be expressly so provided—one is a party to the agreement only to the extent of the securities deposited, but, in the absence of a provision to the contrary, a court may find that one who has signed a deposit agreement as the holder of a stated number of shares of stock is also bound as to after-acquired stocks and bonds.[78]

It is for the depositors that the committee is trustee [79] and it is to them that it owes fiduciary obligations.[80] It is not fruitful to attempt exact definition as to whether the relationship is one of agency, bailment, assignment, or trust. All these terms, and others, have been applied by the courts [81] but all are consistent with the notion of a fiduciary relationship. One of the results is that a depositor may compel the committee to account.[82]

The "agency" of the committee is not such that it may bind the depositors personally in favor of third persons, the committee alone being liable as principal on its contracts.[83] But where the obligations incurred are proper the committee may, in the absence of provisions in the agreement to the contrary, obtain reimbursement from the depositors on an implied agreement by the depositors to pay necessary expenses.[84] And, of course, the committee may bind the deposited securities.[85]

The aim of the courts is to keep all depositors on equality; [86] but the failure of some to perform their obligations [87] does not affect the other depositors,[88] nor serve to relieve the committee from its trusteeship.[89]

The deposit agreement may contain an agreement adopting in advance any plan which the committee may formulate.[90] It is more customary,

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[78] Tillotson v. Independent Breweries Co., 216 Mo. App. 412, 268 S. W. 425 (1925). But *cf.* Riker v. Alsop, 27 Fed. 251 (1886), *rev'd,* (on other grounds), 155 U. S. 448, 15 Sup. Ct. 162 (1894).

[79] United Waterworks, Ltd. v. Stone, *supra* note 59.

[80] Cassagne v. Marvin, *supra* note 75; Carter v. First National Bank, *supra* note 54.

[81] *Agency*—Miller v. Dodge, *supra* note 50; Industrial & Gen. Trust, Ltd. v. Tod, 180 N. Y. 215, 73 N. E. 7 (1904). *Contra:* Mines Management Co. v. Close, 186 App. Div. 23, 174 N. Y. Supp. 80 (1919). *Bailment*—Industrial & Gen. Trust, Ltd. v. Tod, *supra.* *Assignment*—Mines Management Co. v. Close, *supra.* *Trust*—Cowell v. City Water Supply Co., *supra* note 42; United Water Works Co. v. Omaha Water Co., *supra* note 54; American Trust Co. v. Holtsinger, 226 Mass. 30, 114 N. E. 956 (1917); Parker v. New England Oil Corp., 4 F. (2d) 392 (1924), *rev'd,* 19 F. (2d) 903 (C. C. A. 1st, 1927). *Power of Attorney coupled with an interest*—Parker v. New England Oil Corp., 13 F. (2d) 158 (D. Mass. 1926), *rev'd,* 19 F. (2d) 903 (C. C. A. 1st, 1927).

[82] Mawhinney v. Bliss, 117 App. Div. 255, 102 N. Y. Supp. 279 (1907), *aff'd,* 189 N. Y. 501, 81 N. E. 1169 (1907). The court found the allegations of the complaint to be inconsistent with "good faith" on the part of the committee, and refused to pass on the question whether a depositor might, before the committee is afforded a reasonable opportunity to perform, compel an accounting without alleging bad faith, negligence, or breach of trust.

[83] Mines Management Co. v. Close, *supra* note 81.

[84] Fidelity Ins. Co. v. Lenning, 106 Pa. 144 (1884).

[85] Central Trust Co. v. Carter, 78 Fed. 225 (C. C. A. 5th, 1896).

[86] Fuller v. Venable, 118 Fed. 543 (C. C. A. 4th, 1902).

[87] Each depositor must of course comply with the terms of the agreement in order to be entitled to participation. Carpenter v. Catlin, 44 Barb. Ch. 75 (N. Y. 1865).

[88] Cushman v. Bonfield, 139 Ill. 219, 28 N. E. 937 (1891).

[89] Indiana, I. & I. R. R. v. Swanneli, 157 Ill. 616, 41 N. E. 989 (1895).

[90] Ginty v. Ocean Shore R. R., 172 Cal. 31, 155 Pac. 77 (1916); Colonial Trust Co. v. Wallace, *supra* note 52.

however, to require the committee to promulgate a plan and give the depositors the right to dissent therefrom.[91] A provision to the effect that any promulgated plan shall be binding upon all depositors unless a majority dissent is valid.[92]

Depositors may withdraw deposited securities only pursuant to the terms of the deposit agreement,[93] but the abandonment by the committee of its functions,[94] or a breach of duty on the part of the committee [95] may justify withdrawal. Thus it has been held [96] that the issuance of a new bond issue in an amount substantially larger than provided for in the agreement is sufficient to release depositors. In a case [97] where the deposit agreement was construed as imposing no obligation upon the committee, which had the right to terminate the agreement at its pleasure, it was held, in the absence of an express prohibition, that a depositor might withdraw at any time. A clause expressly permitting withdrawal within sixty days from the publication of a plan was there held not to deprive a depositor of the right to withdraw before the formulation of a plan.

Of course, a depositor may cease to be such, if the agreement so provides—and it usually does, not only by dissent and/or withdrawal, but also by the mere transfer to another of his certificate of deposit, but then the securities remain bound and the transferee becomes the depositor.

Non-Depositors and Third Persons

The agreement need not be open to all the security holders of a corporation, nor even to all of the same class.[98] While, ordinarily, the committee endeavors to procure the largest amount of deposited securities of the permitted class, there is no obligation upon the committee to call attention to its existence or to solicit deposits.[99]

Although there may be circumstances under which the committee may become chargeable with fiduciary obligations to other interested parties,[100] it may be stated as a general rule that the committee owes no duty to non-

[91] The dissent must be *in toto;* that is, one may not accept parts of the plan and reject other parts. Miller v. Dodge, *supra* note 50.

[92] Cowell v. City Water Supply Co., *supra* note 42.

[93] Habirshaw Electric Cable Co. v. Habirshaw Electric Co., *supra* note 53.

[94] Lucey Mfg. Corp. v. Morlan, 14 F. (2d) 920 (C. C. A. 9th, 1926).

[95] Industrial & Gen. Trust, Ltd. v. Tod, 180 N. Y. 215, 73 N. E. 7 (1904).

[96] Miller v. Rutland & Washington R. R., 40 Vt. 399 (1867).

[97] Colonial Trust Co. v. Wallace, *supra* note 52; *cf.* Habirshaw Electric Cable Co. v. Habirshaw Electric Co., *supra* note 53 at 880.

[98] Fidelity Ins. & Safe Deposit Co. v. Roanoke Street Ry., 98 Fed. 475 (C. C. W. D. Va. 1899); Munson v. Magee, 22 App. Div. 333, 47 N. Y. Supp. 942 (1897), *aff'd,* 161 N. Y. 182, 55 N. E. 916 (1900); Moss v. Geddes, 28 Misc. 291, 59 N. Y. Supp. 867 (1899). In reorganizations under judicial supervision, the court may possibly insist upon a reasonable right of participation for all of the same class; but as to that see *supra* note 5. It is generally required, either by statute or decision, that voting trust agreements be open to all stockholders.

[99] Moss v. Geddes, *supra* note 98. Voting trust statutes generally require that voting trust agreements be public and open to inspection by all stockholders.

[100] See Parker v. New England Oil Co., 8 F. (2d) 392 (D. Mass. 1925), *rev'd,* 19 F. (2d) 903 (C. C. A. 1st, 1927).

depositors.[101] But it should be careful not to hold itself out as acting for all.[102] Provisions in the deposit agreement indicating that holders of other classes of securities may be permitted certain participation under the plan, may be only *ex gratia* and not impose any liability in their favor.[103]

A non-depositor may not compel the acceptance of his securities after the expiration of the time limited for deposit, even though the committee may be accepting belated deposits from others.[104] On the other hand, the committee having accepted a deposit after the time limited therefor, a demand on the part of depositors that the late-comers be excluded will be regarded as lacking "the essential element of equity".[105] Even where participation may be compelled, it must be sought seasonably.[106]

Generally, the subject of "strangers' dealings" with the committee may be sufficiently summarized by saying, in addition to what has already been noted, that they are held chargeable with notice as to the terms of the deposit agreement.[107] However, the terms of the agreement will probably be liberally construed in favor of innocent third persons, particularly where the complaining depositor has received benefits or has been guilty of laches.[108]

Committee Communications

Active committees make it a practice to issue from time to time statements as to their progress and prospects. Although this desire to make their proceedings public is a wholly laudatory one, great care must be exercised in the preparation of all committee communications to depositors, non-depositors, and to the depositary. The need for caution arises especially, because, under the usual agreement, the committee is empowered to take various actions which become effective and binding upon the giving of certain specified notice. It is, therefore, important always to distinguish sharply between mere informative announcements and notices of formal action. These matters do not frequently reach the stage of litigation, but there is at least one reported case [109] that indicates the danger. In that case, a "Plan and Agreement of Reorganization" provided for the issuance of first mortgage bonds in an amount up to $100,000,000. The committee was empowered to modify the agreement in respects deemed by it not substantial; and the agreement further provided for substantial changes by the

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[101] Bound v. South Carolina R. R., 78 Fed. 49 (C. C. A. 4th, 1897).
[102] Walker v. Whelan, 4 Phila. 389 (Pa. 1861).
[103] Miller v. Dodge, *supra* note 50.
[104] Keane v. Moffly, *217* Pa. *240*, 66 Atl. 319 (1907).
[105] Walker v. Montclair & Greenwood Lake Ry., 30 N. J. Eq. 525 (1879). This was a proceeding to set aside a foreclosure sale; but query whether the same result would be reached in a direct proceeding promptly brought to enforce the terms of the agreement. This note of course assumes that the deposit agreement, contrary to the usual practice, vests no discretion in the committee as to the time within which to accept deposits.
[106] Landis v. West Pa. R. R., 133 Pa. 579, 19 Atl. 556 (1890).
[107] Central Trust Co. v. Carter, 78 Fed. 225 (C. C. A. 5th, 1896).
[108] Lyman v. Kansas City & A. R. R., 101 Fed. 636 (C. C. W. D. Mo. 1900).
[109] Barnard v. Fitzgerald, 23 Misc. 181, 50 N. Y. Supp. 309 (1898).

committee, provided a copy of the proposed change be lodged with the depositary and advertised. The committee issued an announcement that "no material modification of the plan appears necessary except that the two classes of the junior bonds . . . may have to be offered a somewhat smaller allotment in the new first mortgage bonds . . . so as to enable the committee to limit the issue of new first mortgage 4 per cent bonds [which under the plan was fixed at $100,000,000] to $75,000,000 for reorganization purposes, . . ." The announcement concluded with the statement:

> "While modifications in the other features of the plan appear not to be required under present conditions, the committee deems it prudent to postpone the formal declaration that the plans all become operative. . . ."

Thereafter the committee declared operative the "plan of reorganization with the modification heretofore published". Upon the reorganization the committee found it necessary to issue $90,000,000 of new first mortgage bonds. The plaintiff sued to restrain the issuance of more than $75,000,000, claiming that the committee's announcement constituted a modification of the plan.

The decision was in favor of the committee because no modification was filed with the depositary, the advertising of the notice was not in the manner specified for modifications, and no provision for dissent and withdrawal was made as required by the agreement in cases of modification. The court also held that the announcement "did not constitute a representation or warranty binding upon the committee".

Termination of Agreement and Accounting by Committee

Most agreements provide for a definite date of termination,[110] coupled with some limited power to the committee to extend the date, and give to the committee unlimited power to terminate the agreement at any earlier date.[111]

It is customary to impose upon the committee the duty to account at the termination of the agreement and to provide the mechanics therefor.[112]

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[110] This may be required by certain stock exchanges, if the certificates of deposit are to be listed. The New York Stock Exchange requires that deposit agreements terminate within five years.

[111] The power to terminate the agreement does not render it void for want of mutuality. White v. McCullagh, 74 W. Va. 160, 81 S. E. 720 (1914). But see Colonial Trust Co. v. Wallace, *supra* note 52.

[112] The committee may maintain an action in equity for the settlement of its accounts. Mills v. Potter, 189 Mass. 238, 75 N. E. 627 (1905); Coppell v. Hollins, *supra* note 45. Apparently, in the absence of provisions to the contrary in the agreement, all depositors would be necessary defendants. For a case involving an accounting by voting trustees upon a sale of the deposited stock pursuant to a supplemental agreement authorizing such sale see Lewis v. Adriance, 100 Misc. 725, 166 N. Y. Supp. 774 (1916), *aff'd*, 179 App. Div. 958 (1917), *aff'd*, 226 N. Y. 663, 123 N. E. 876 (1919).

Where the organization or reorganization of a corporation is contemplated, the accounting may be rendered to the board of directors of the corporation. Where the entire corporation is not involved, the committee may file an accounting with the depositary under appropriate provisions of the agreement, making such filed account conclusive upon all depositors who do not object thereto within a limited time. In case of objections the newer agreements provide for the arbitration of disputed items.

Conclusion

So long as corporations continue to exist with private ownership of their securities, so long will the problem of their control be a vital one. The mechanics of control are diverse. The protective committee device, which has rendered very many years of valuable aid in corporate reorganizations, is capable of extension as an important adjunct to proxy-committees and voting trusts in struggles over corporate policies. Its technique, generally uniform, is simple and well known; the law governing it is reasonably well settled. The apparent inconsistencies in the decisions can in large measure be avoided by careful draftsmanship, always remembering, however, that courts will be greatly influenced by their views of the equities. Barring basic economic changes or widespread and notorious abuses of the device, it may be assumed that the protective committee will continue to play a prominent role in corporate affairs.